

Report
of the
Examination of
Blue Cross & Blue Shield United of Wisconsin
Milwaukee, Wisconsin
As of December 31, 2000

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott McCallum, Governor
Connie L. O'Connell, Commissioner

Wisconsin.gov

September 16, 2001

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Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
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Commissioners:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

BLUE CROSS & BLUE SHIELD UNITED OF WISCONSIN
Milwaukee, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1998 as of December 31, 1997. The current examination covered the intervening period ending December 31, 2000, and included a review of such 2001 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance (OCI). They reviewed the adequacy of health reserves, cash flow testing, due and uncollected premiums for health insurance, and in force testing. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

Blue Cross & Blue Shield United of Wisconsin (BCBSUW) was incorporated in 1939 as a non-profit hospital service membership corporation under the name of Associated Hospital Services, Inc. Associated Hospital Service, Inc. was operated in close affinity with Surgical Care, the Blue Shield Plan of the Medical Society of Milwaukee County, Wisconsin (hereinafter also, "Surgical Care"). Cooperative efforts encompassed marketing and rate making.

Surgical Care was an unincorporated, nonprofit service plan that operated as a sickness care plan. This plan, established in December 1943, operated as a division of the Medical Society of Milwaukee County. It provided medical and surgical coverage as a companion writer to Associated Hospital Service, Inc.

On May 5, 1976, legislation was enacted in Wisconsin to require the incorporation of unincorporated, nonprofit service plans. Surgical Care applied for a certificate of incorporation and a certificate of authority to be issued to a corporation to be known as Surgical Care - Blue Shield, Inc. Under the plan of incorporation, all of the assets and liabilities of the unincorporated, non-profit service plan were transferred to the corporation. The Medical Society of Milwaukee County (the "society") was held harmless from any claim, demand, action, or proceeding made on, before, or after the date of transfer arising from, or claimed to arise from, the Society's ownership or operation of Surgical Care. After OCI granted several extensions of the time permitted for incorporation pursuant to s. 610.46(3), Wis. Statutes, Surgical Care – Blue Shield, Inc. was issued a certificate of authority on November 20, 1978.

On December 28, 1979, under an agreement and plan of merger and reorganization, Surgical Care - Blue Shield, Inc. transferred all of its operations, including all assets and liabilities, to Associated Hospital Service, Inc. The name of Associated Hospital Service, Inc. was changed simultaneous with the date of this transfer and reorganization to that currently used. Surgical Care - Blue Shield, Inc. retained its corporate existence following the reorganization for the purpose of ensuring that there was no oversight in any matter of regulatory compliance or the transfer of operations, assets, and liabilities. Surgical Care - Blue Shield, Inc. was dissolved effective December 31, 1981.

Over time, BCBSUW acquired several stock subsidiaries, all of which were engaged in the business of insurance or activities ancillary to the business of insurance. In 1983, BCBSUW organized a downstream holding company, United Wisconsin Services, Inc. (hereinafter also, "UWSI"). At first, UWSI was wholly owned by BCBSUW and became the direct owner of all of BCBSUW's stock subsidiaries.

In 1990, UWSI entered into a joint venture agreement with American Medical Security, a third party administrator, to nationally market and administer small group health insurance policies issued by the UWSI subsidiary, United Wisconsin Life Insurance Company.

In 1991, BCBSUW sold 18.7% of its holdings in UWSI in an initial public offering. In 1994, BCBSUW sold additional shares representing 18% of UWSI in a secondary offering and contributed shares representing 2% of UWSI to the United Wisconsin Services Foundation. As a result of these and other actions, BCBSUW's ownership percentage in UWSI was reduced to 59.7% as of December 31, 1994. In 1994, UWSI's stock was listed on the New York Stock Exchange under the ticker symbol "UWZ". In 1995, another secondary offering of UWSI stock reduced BCBSUW's ownership percentage to 49.3%.

In 1996, UWSI exercised its option under the joint venture agreement with American Medical Security to purchase the remaining interest in the joint venture, the third party administrator and its affiliates from its principal owners for \$67 million in cash and 3,694,280 newly issued common shares of UWSI. The additional share issuance reduced BCBSUW's ownership percentage in UWSI to 38%. To finance the cash portion of the purchase price, UWSI borrowed \$70 million from BCBSUW under a Promissory Note and Pledge Agreement. The note was originally due on October 30, 1999, but has since been replaced to extend until January 1, 2002. The loan is secured by all of the common stock of Compcare Health Services Insurance Corporation (hereinafter also, "Compcare"), a Wisconsin domiciled health maintenance organization (HMO).

In late 1998, the specialty products and HMO business segment of UWSI was spun off to a new holding company, which took the UWSI name. The original UWSI, the holding company for the small group health insurance segment, was renamed American Medical Security Group, Inc. ("AMSG"). At the time of the spin-off, BCBSUW owned 38.1% of AMSG. AMSG's share repurchase programs have increased BCBSUW's ownership of AMSG to over 46%.

Effective January 1, 1999, the division of BCBSUW that administered Medicare and Medicaid programs, among other services to government entities, was separated into a wholly owned subsidiary of BCBSUW, United Government Services, LLC. The Blue Cross Blue Shield Association issued a small affiliate license to United Government Services, LLC.

In August 1999, BCBSUW began to purchase UWSI's common shares in the public market. These purchases continued until BCBSUW owned approximately 46% of the outstanding shares of UWSI. The multiple employer pension plan in which BCBSUW and UWSI participate and also the UWSI/BCBSUW employee 401k plan purchased UWSI's common shares until each of these two employee benefit plans owned approximately 3% of UWSI. The increase in ownership by BCBSUW and the employee benefit plans was undertaken to comply with the Blue Cross Blue Shield Association's 50% ownership requirement in order to allow Compcare to use its trademarks.

On June 14, 1999, BCBSUW filed an application with OCI to convert from a nonprofit service insurance corporation to a stock corporation. On March 28, 2000, Commissioner O'Connell approved the plan of conversion subject to a detailed list of conditions. On March 19, 2001, the Commissioner recognized BCBSUW's application as complete and approved the conversion pursuant to her order of March 28, 2000. Effective March 23, 2001, BCBSUW converted to stock insurance corporation and organized pursuant to Ch. 611, Wis. Stat. In addition to the conversion, BCBSUW became a wholly owned subsidiary of Cobalt through a combination of BCBSUW and Cobalt on March 23, 2001.

The new organizational chart and a brief description of changes as a result of the conversion and combination are described in the section of this report captioned, "Affiliated Companies".

The company operates throughout the state of Wisconsin. BCBSUW offers a full range of health-related products provided on a self-insured basis and an insured basis, including pool-rated, group-rated, and self-insured health coverages, along with dental and prescription drug products. Individual health products are also available.

The following chart is a summary of the net insurance premiums written by the company in 2000.

The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Comprehensive (Hospital & Medical)	\$363,463,422		\$360,833	\$363,102,589
Medical Supplemental	79,104,072			79,104,072
Dental	29,448,415			29,448,415
Federal Employee Health Benefit Plans	64,329,777			64,329,777
Other	<u>3,211,044</u>	<u>4,662,930</u>	<u>83,132</u>	<u>7,790,842</u>
Total All Lines	<u>\$539,556,730</u>	<u>\$4,662,930</u>	<u>\$443,965</u>	<u>\$543,775,695</u>

The company acquires business using both an agency and direct marketing system. The internal sales force is divided into four BCBSUW regions, each with its own regional director, to sell group products. The internal sales representatives report to the respective regional sales director. BCBSUW's individual and Medicare supplemental products are sold via internal sales representative in the individual plan market department (IPM). IPM primarily uses direct mail, newspaper and television advertising, and telemarketing to solicit its customers. In addition, the IPM contracts with external independent agencies to market BCBSUW's individual products. BCBSUW also sells individual and group (2–99 employees) products directly to consumers via the internet. This is supported by a centralized Internet sales and service team in Oshkosh, Wisconsin.

The company also provides administrative services for self-insured groups. BCBSUW incurred a net loss of \$11.9 million for 2000 on administration of uninsured accident and health plans and the uninsured portion of partially insured plans.

III. MANAGEMENT AND CONTROL

Board of Directors

As of December 31, 2000, the BCBSUW board of directors consisted of nine members. Eight are elected annually to serve a three-year term with as close to one-third of the directors as possible being elected each year, and one is an ex-officio director by virtue of holding the office of chairman of the board. Officers for the board are elected at the board's annual meeting.

Members of the BCBSUW board may also be members of other boards of directors in the holding company group. The outside board members currently receive a retainer of \$1,917 per month, \$1,100 per board and/or committee meeting attended, and as a committee chairman they receive an annual retainer of \$3,000 at the time of appointment.

At December 31, 2000, the BCBSUW board of directors consisted of the following persons:

Name and Residence	Principal Occupation	Term Expires
Thomas A. Bausch Wauwatosa, Wisconsin	Professor-Business Administration Marquette University	2002
James L. Forbes River Hills, Wisconsin	President and CEO Badger Meter, Inc.	2003
Thomas R. Hefty Elm Grove, Wisconsin	Chairman and CEO Blue Cross & Blue Shield United of Wisconsin	
James C. Hickman Madison, Wisconsin	Professor-School of Business University of Wisconsin-Madison	2002
Michael S. Joyce West Bend, Wisconsin	President and CEO The Lynde and Harry Bradley Foundation	2003
Donald P. Muench Brookfield, Wisconsin	Retired – Treasurer, Cross & Trecker	2001
Kenneth M. Viste, Jr., M.D. Oskosh, Wisconsin	Doctor of Neurology	2003
D. Keith Ness, M.D. Mauston, Wisconsin	Physician & President Community Physician's Network	2002
Janet D. Steiger Washington, D.C.	Retired from the Federal Trade Commission	2001

Officers of the Company

The officers serving at December 31, 2000 are as follows:

Name	Office	2000 Compensation
Thomas R. Hefty	Chairman, President, and CEO	\$652,011*
Stephen E. Bablich	General Counsel, Senior Vice President, and Secretary	279,041*
Gail Hanson	Senior Vice President, Treasurer and CFO	265,136*

* Compensation includes amounts allocated to all affiliates.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors.

The committees at December 31, 2000 are listed below:

Executive Committee

James L. Forbes, Chair
Thomas R. Hefty
James C. Hickman
Kenneth M. Viste, Jr.

Finance Committee

Donald P. Muench, Chair
Thomas R. Hefty
D. Keith Ness
Kenneth M. Viste, Jr.

Audit Committee

Thomas A. Bausch, Chair
James L. Forbes
James C. Hickman
Janet D. Steiger

Special Committee

Michael S. Joyce
Janet D. Steiger
Kenneth M. Viste, Jr.

Management Review Committee

James L. Forbes, Chair
James C. Hickman
Michael S. Joyce
Janet D. Steiger

IV. AFFILIATED COMPANIES

Blue Cross & Blue Shield United of Wisconsin (BCBSUW) is a member of an insurance holding company system. Below is a brief description of the significant affiliates of BCBSUW. The organizational chart, which depicts the relationships among the affiliates in the group, as of March 31, 2001, follows the descriptions.

Cobalt Corporation

Cobalt Corporation (Cobalt), formerly known as United Wisconsin Services, Inc.(UWSI), operates as an insurance holding company for the group. UWSI was incorporated in 1998 and organized pursuant to ch. 180, Wis. Stat. UWSI was publicly traded over the New York Stock Exchange under the symbol UWZ until March of 2001. Effective March 23, 2001, UWSI changed its name to Cobalt Corporation upon completion of the conversion of Blue Cross & Blue Shield United of Wisconsin (BCBSUW) and the combination of BCBSUW and UWSI. Currently, Cobalt is traded on the New York Stock Exchange under the symbol CBZ.

Subsequent to the conversion and combination, the majority of Cobalt's common stock is owned by the Wisconsin United for Health Foundation (the foundation). The foundation's ownership percentage is dependent on whether the 16.4% of Cobalt common stock owned by BCBSUW is treated as treasury stock or not. If BCBSUW owned Cobalt stock it is considered treasury stock the foundation owns 77.5% of Cobalt. See the organizational chart, following this section for more detail.

The December 31, 2000, audited consolidated financial statements for UWSI reported assets of \$366 million, liabilities of \$349 million, and shareholders' equity of \$17 million. Operations for 2000 produced net losses of \$16 million on revenues of \$761 million.

Wisconsin United for Health Foundation, Inc.

Wisconsin United for Health Foundation, Inc. (the foundation) is a non-stock organization organized pursuant to Ch. 181, Wisconsin Statutes. It was created as part of the for-profit stock company. The foundation was established for the purpose of benefiting public health transaction under which BCBSUW was converted from a non-stock, non-profit organization to a initiatives developed by the University of Wisconsin Medical School and the Medical College of Wisconsin. Under a divestiture agreement, the foundation is required to sell down its holdings in Cobalt to less than 20% within five

years and to contribute the proceeds from the sale to the University of Wisconsin Medical School and the Medical College of Wisconsin. The foundation was unfunded as of December 31, 2000.

American Medical Security Group, Inc.

American Medical Security Group, Inc. (AMSG), operates as an insurance holding company for the individual and small employer group health care benefits segments of the group. AMSG was incorporated in 1983 and organized pursuant to ch. 180, Wis. Stat.. The December 31, 2000, audited consolidated financial statements for AMSG reported assets of \$472 million, liabilities of \$251 million, and shareholders' equity of \$221 million. Operations for 2000 produced net income of \$2.7 million on revenues of \$990 million. AMSG is publicly traded over the New York Stock Exchange under the symbol AMZ.

United Government Services, LLC

United Government Services, LLC, (UGS) is a Wisconsin limited liability company organized effective January 1, 1999, pursuant to ch.183, Wis. Stat. BCBSUW is the sole member of UGS. UGS provides administrative, program integrity, and consulting services in connection with the publicly funded health care programs. The December 31, 2000, audited financial statements for UGS reported assets of \$22 million, liabilities of \$15 million, and shareholders' equity of \$7 million. Operations for 2000 produced net income of \$1.2 million on revenues of \$71 million.

Compcare Health Services Insurance Corporation

Compcare Health Services Insurance Corporation (Compcare) is a Wisconsin stock insurance corporation incorporated January 1, 1984, under the provisions of ch. 611, Wis. Stat. It operates as a health maintenance organization in the state of Wisconsin. Compcare's 2000 statutory annual statement reported assets of \$143 million, liabilities of \$94 million, and net worth of \$49 million. Operations for 2000 produced a net loss of \$10 million on total revenues of \$392 million.

Unity Health Plans Insurance Corporation

Unity Health Plans Insurance Corporation (Unity) is a Wisconsin stock insurance corporation incorporated on October 1, 1983, and organized pursuant to ch. 611, Wis. Stat. It operates as a health maintenance organization in the state of Wisconsin. Unity's 2000 statutory annual statement reported assets of \$39 million, liabilities of \$28 million, and net worth of \$11 million. Operations for 2000 produced a net loss of \$2.6 million on total revenues of \$160 million.

Valley Health Plan, Inc.

Valley Health Plan, Inc. (Valley), is a Wisconsin stock insurance corporation incorporated on June 1, 1988, and organized pursuant to ch. 611, Wis. Stat. It operates as a health maintenance organization in the state of Wisconsin. Valley's 2000 statutory annual statement reported assets of \$19 million, liabilities of \$12 million, and net worth of \$7 million. Operations for 2000 produced a net loss of \$576 thousand on total revenues of \$79 million.

United Heartland Life Insurance Company

United Heartland Life Insurance Company (UHLIC) is a stock insurance company, incorporated as National Benefit Life Assurance Company on August 23, 1990, and organized pursuant to ch. 611, Wis. Stat. UHLIC is a wholly owned subsidiary of Compcare and provides group term life, individual whole life, and group accidental death and dismemberment coverages. As of December 31, 2000, UHLIC's statutory annual statement reported assets of \$21 million, liabilities of \$11 million, and surplus of \$10 million. Operations for 2000 produced a net income of \$1.6 million on revenues of \$28 million.

United Wisconsin Insurance Company

United Wisconsin Insurance Company (UWIC) is a Wisconsin stock insurance corporation, incorporated in 1957, and organized pursuant to ch. 611, Wis. Stat. UWIC, a wholly owned subsidiary of Compcare, has established, maintained, and operated accident, sickness, long-term disability, and other health care insurance plans. As of December 31, 2000, the company's statutory annual statement reported assets of \$86 million, liabilities of \$48 million, and capital and surplus of \$38 million. Operations for 2000 a produced net loss of \$2 million on revenues of \$70 million.

United Wisconsin Life Insurance Company

United Wisconsin Life Insurance Company (UWLIC), is a Wisconsin stock insurance corporation incorporated in 1982 and organized pursuant to Chapter 611 of the Wisconsin Statutes. UWLIC is a wholly owned subsidiary of American Medical Security Holdings, Inc. and provides life and health insurance and related coverages. UWLIC's 2000 annual statement reported assets of \$315 million, liabilities of \$168 million, and capital and surplus of \$147 million. Operations for 2000 produced a net income of \$7 million on revenues of \$952 million.

Affiliated Agreements and Guarantees

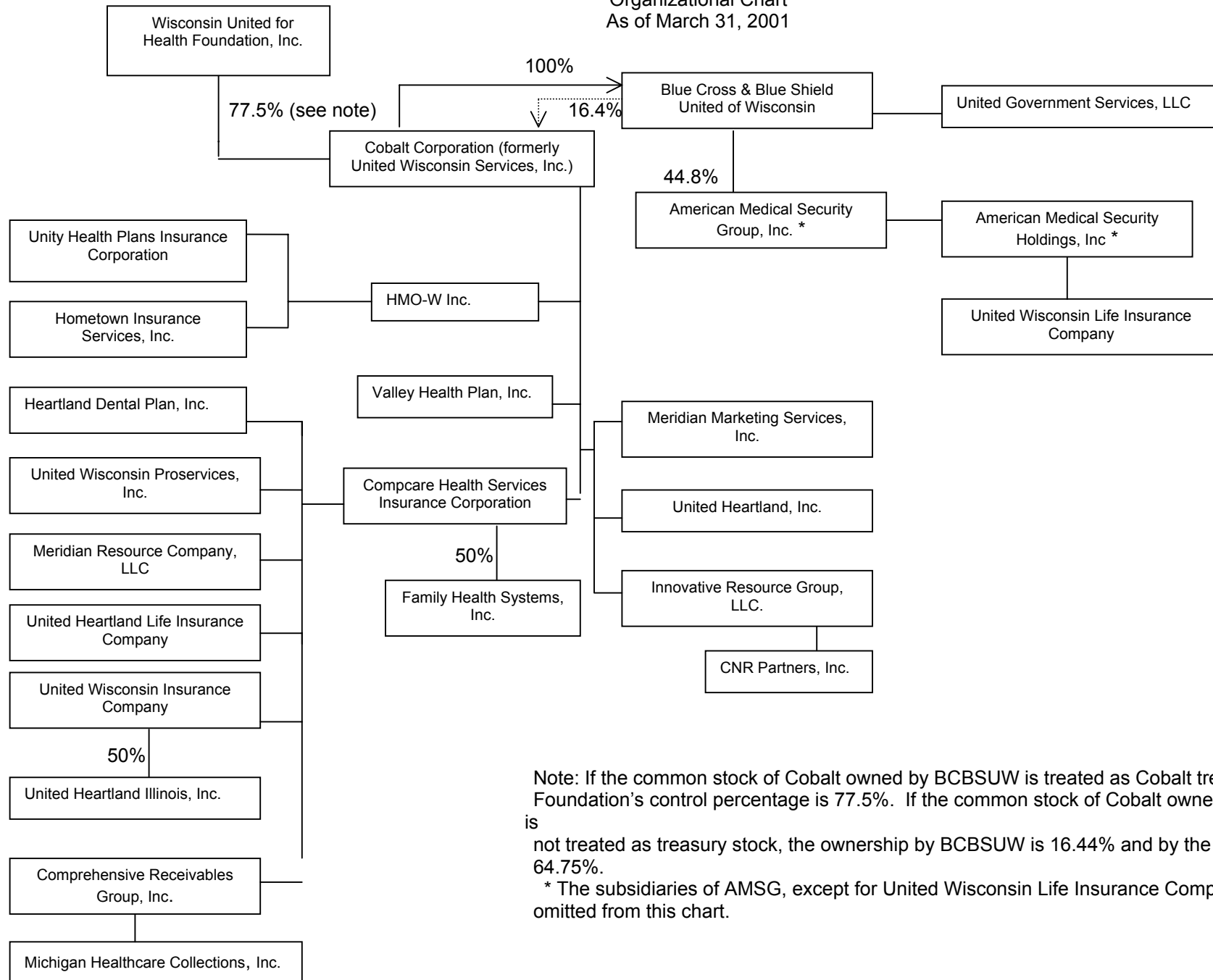
BCBSUW and its affiliates are parties to numerous affiliated agreements. Most of these agreements are between BCBSUW, Cobalt and other affiliates for the continued operations of that affiliate. These agreements contain basically the same provisions, where Cobalt provides the employees and BCBSUW provides the office space and facilities, central systems, and building and office services. Some of the parties to these agreements are United Wisconsin Insurance Company, Meridian Resource Company, Meridian Marketing Innovative Resources Group, and United Wisconsin Proservices. The agreements call for services to be provided on an actual cost or negotiated fee basis.

There is also an agreement in place in between BCBSUW and Cobalt. Under the terms of the agreement, BCBSUW provides Cobalt office space, building services, office services, and central systems and Cobalt provides to BCBSUW corporate support services, executive services, marketing and communications, human resources, financial services, actuarial, and underwriting. Services are to be provided on an actual cost basis.

Under the membership rules of the BlueCross BlueShield Association, BCBSUW, the primary licensee, is required to enter into indemnification or guarantee agreements on behalf of its licensed affiliates. As of December 31, 2000, BCBSUW had entered into such agreements with UGS and Compicare. Under the terms of the agreements BCBSUW indemnifies the BlueCross BlueShield Association against any claims asserted against it resulting from the contractual and financial obligation of

the affiliated licensee (UGS and Compcare). Effective March 23, 2001, Cobalt replaced BCBSUW as the primary licensee with the BlueCross Association. As such BCBSUW was released on indemnification agreements and replaced by Cobalt. BCBSUW also has guaranteed the borrowings by Cobalt against its \$15 million line of credit with M & I Bank. A secondary agreement requires Cobalt to reimburse BCBSUW if BCBSUW is required to repay the bank for a draw by Cobalt.

Organizational Chart
As of March 31, 2001



Note: If the common stock of Cobalt owned by BCBSUW is treated as Cobalt treasury stock, the Foundation's control percentage is 77.5%. If the common stock of Cobalt owned by BCBSUW is not treated as treasury stock, the ownership by BCBSUW is 16.44% and by the Foundation is 64.75%.

* The subsidiaries of AMSG, except for United Wisconsin Life Insurance Company, have been omitted from this chart.

V. REINSURANCE

The company had two ceding and three assuming reinsurance contracts in effect at the time of the examination. BCBSUW cedes to MedAmerica Insurance Company, on a 50% quota share basis, net premium written on all long-term care policies issued or renewed by BCBSUW on and after July 13, 1998, the contract effective date. The company also has an excess of loss contract with Munich American Reassurance Company that covers commercial, indemnity, preferred provider organization and stop loss coverage provided to self-funded plans. The company's retention is \$500,000 of loss or losses incurred by each covered person during the agreement year, subject to the following limitations: 1) Inpatient hospital expense is limited to a maximum average of \$6,000 per day for each period of continuous confinement. 2) Extended Care, Skilled Nursing, or Rehabilitation facilities, or Home Health Care Visits shall be reimbursed at the lessor of the amount paid by the company, \$500 a day, or a negotiated provider fee. 3) Outpatient hospital expenses are limited to the lessor of the amount paid by the company, a negotiated provider fee, or billed charges. 4) Professional expenses are limited to the lessor of a negotiated provider fee, the amount paid by the company, or reasonable and customary charges. 5) Drug expenses are limited to the lessor of the amount paid by the company, a negotiated provider fee, 100% of the average whole sale price, or billed charges. Maximum reinsurance indemnity payable shall be calculated on a combined basis of \$2,000,000 of hospital expenses and professional expenses in excess of the retention for each covered person in each agreement year. The maximum reimbursement for procurement charges is \$10,000 of coverage per covered person per agreement year. The contract with Munich American Reassurance Company did not contain the proper insolvency provisions; refer to the section titled Summary of Current Examination Results for more detail. The other contract contained proper insolvency provisions.

Effective June 1, 2000, Wellmark Community Insurance, Inc. (WCI), an Iowa domiciled company and Wellmark, Inc., an Iowa corporation, entered into an Assumption and Administration Agreement with BCBSUW and UWIC. Under this agreement, BCBSUW purchased all of WCI's group and individual health, dental and related conversion plans in Wisconsin. In addition, UWIC purchased all of WCI's Wisconsin Medicare supplement book of business, which is then ceded to BCBSUW on a 100% quota share basis. Under the administration agreement BCBSUW and UWIC are responsible for creating

and mailing all assumption certificates to policyholders in advance of the final date for transfer of administration. The administration agreement contains provisions for the parties to compensate one another for premium billing and claim administration during the transition period. For claims that incurred between January 1, 2000 and May 31, 2000, BCBSUW and UWIC were paid by WCI for claims administration. WCI was paid compensation for premium billing services from June 1, 2000 to October 31, 2000.

BCBSUW assumes from UWIC, on a 100% quota share basis, the group comprehensive major medical for the United Dairy Trust and United Dairy Plan business. This business is marketed and administered by BCBSUW but was written on UWIC paper, as BCBSUW is not licensed in Iowa or Minnesota. BCBSUW also assumes from UWIC, on a 100% quota share basis certain individual insurance policies and temporary insurance policies. This contract also covers the Medicare supplement business assumed from WCI. These contracts contained proper insolvency provisions.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2000, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the company for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Blue Cross & Blue Shield United of Wisconsin
Assets
As of December 31, 2000

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	\$29,951,437	\$	\$	\$29,951,437
Stocks:				
Preferred stocks	1,500,000			1,500,000
Common stocks	57,574,107	59,159,087		116,733,194
Real estate:				
Occupied by the company	5,174,679			5,174,679
Cash	(9,625,272)			(9,625,272)
Short-term investments	5,767,181			5,767,181
Other invested assets	74,628,000			74,628,000
Uncollected premiums	3,325,311		63,030	3,262,281
Amounts receivable relating to uninsured accident and health plans	5,644,713			5,644,713
Funds held by or deposited with reinsured companies	167,395			167,395
Reinsurance ceded:				
Experience rating and other refunds due	108,916			108,916
Electronic data processing equipment	1,889,907			1,889,907
Federal income tax recoverable and interest thereon	11,576,308		11,576,308	
Investment income due and accrued	464,754			464,754
Receivable from parent, subsidiaries and affiliates	11,873,930			11,873,930
Other assets nonadmitted:				
Furniture and equipment	12,504,487		12,504,487	
Write-ins:				
Investment – Deferred Salaries	2,796,330			2,796,330
Cash Surrender Value of life ins	547,832			574,832
Claim Collection	7,694,091		1,133,798	6,560,293
Deposits with National Associations	260,424			260,424
Interest Receivable	49,003			49,003
Miscellaneous Accounts Receivable	156,325		9,027	147,298
Prepaid Expenses	38,205,517		38,205,517	
Goodwill	895,084			895,084
Total Assets	<u>\$263,130,459</u>	<u>\$59,159,087</u>	<u>\$63,492,167</u>	<u>\$258,797,379</u>

Blue Cross & Blue Shield United of Wisconsin
Liabilities, Surplus, and Other Funds
As of December 31, 2000

Claims Unpaid	\$ 87,411,038
Unpaid claims adjustment expenses	2,707,787
Unearned premiums	40,508,813
Taxes, licenses and fees due or accrued (excluding federal income taxes)	911,446
Other expenses due or accrued	13,212,840
Amounts withheld or retained for others	2,033,060
Liability for amounts held under uninsured	2,303,116
Write-ins for liabilities:	
Deferred Compensation	4,066,029
Subscriber Deposits	236,080
Liability for Non-Express Items	117,829
Accrued Post Retirement Benefits	<u>933,212</u>
Total Liabilities	154,441,250
Unassigned funds	<u>104,356,129</u>
Total Liabilities, Surplus, and Other Funds	<u>\$258,797,379</u>

Blue Cross & Blue Shield United of Wisconsin
Summary of Operations
For the Year 2000

Premiums earned	<u>\$534,399,173</u>
Claims incurred	490,524,165
Expenses incurred:	
Claim adjustment	29,718,703
Administrative	30,575,752
Soliciting	<u>20,920,746</u>
Total underwriting deductions	<u>571,739,366</u>
Net underwriting loss	<u>(37,340,193)</u>
Net investment income earned	9,625,290
Net realized capital loss	<u>(508,524)</u>
Net investment gain	<u>9,116,766</u>
Net loss before federal income taxes	<u>(28,223,427)</u>
Net loss	<u>\$(28,223,427)</u>

Blue Cross & Blue Shield United of Wisconsin
Cash Flow
As of December 31, 2000

Premiums collected net of reinsurance	\$543,265,578	
Claims and claims adjustment expenses	497,812,077	
Underwriting expenses paid	<u>51,316,650</u>	
Cash from underwriting	(5,863,149)	
Investment Income	10,040,556	
Federal income taxes recoverable	<u>200,000</u>	
Net cash from operations		\$ 4,377,407
Proceeds from investments sold, matured, or repaid:		
Bonds	20,306,636	
Stocks	24,285,440	
Other invested assets	<u>4,302,280</u>	
Total investment proceeds		\$48,894,356
Cost of investments acquired (long-term only):		
Bonds	7,226,214	
Stocks	19,022,789	
Other invested assets	2,970,280	
Miscellaneous applications	<u>895,084</u>	
Total investments acquired	<u>30,114,367</u>	
Net cash from investments		18,779,989
Other cash provided:	6,198,950	
Other cash applied:		
Net transfers to affiliates	2,560,362	
Borrowed funds repaid	11,175,000	
Other applications	<u>9,703,546</u>	
Total other cash applied	<u>23,438,908</u>	
Net cash from financing and miscellaneous sources		<u>(17,239,958)</u>
Net change in cash and short-term investments		5,917,438
Reconciliation		
Cash and short-term investments, December 31, 1999		<u>\$ (9,775,530)</u>
Cash and short-term investments, End of year		<u>\$ (3,858,092)</u>

**Blue Cross & Blue Shield United of Wisconsin
Compulsory and Security Surplus Calculation
December 31, 2000**

Reported Assets	\$258,797,379	
Less reported liabilities	<u>154,441,250</u>	
Reserves and unassigned funds		104,356,129
Examination Adjustments		(6,641,415)
Less investment in UWSI insurance subsidiaries, reflecting The 46.62999% ownership in UWSI:		
Compicare Health Services Insurance Corporation	(48,935,025)	
Unity Health Plans Insurance Corporation	(10,940,947)	
Valley Health Plan, Inc.	<u>(7,195,960)</u>	
UWSI subsidiaries security surplus deductions	(67,071,932)	
	<u>X 46.62999%</u>	(31,275,635)
Add security surplus excess of UWSI insurance subsidiaries, Reflecting the 46.62999% ownership in UWSI:		
Compicare Health Services Insurance Corporation	13,734,493	
Unity Health Plans Insurance Corporation	2,788,166	
Valley Health Plan, Inc.	<u>3,192,087</u>	
UWSI subsidiaries security surplus deductions	19,714,746	
	<u>X 46.62999%</u>	9,192,985
Adjustment to limit the security surplus adjustment to the investment in UWSI*		13,655,956
Deduction of 30% of AMSG book value		<u>(28,418,375)</u>
Adjusted reserves and unassigned funds per examination		\$60,869,645
Annual premium:		
Individual accident and health	\$161,756,000	
Factor	<u>15%</u>	
Total		24,263,400
Group accident and health	308,313,000	
Factor	<u>10%</u>	
Total		<u>30,831,300</u>
Compulsory surplus		<u>55,094,700</u>
Compulsory surplus excess		<u>\$5,774,945</u>

**Blue Cross & Blue Shield United of Wisconsin
Compulsory and Security Surplus Calculation
December 31, 2000
(continued)**

Adjusted reserves and unassigned funds per examination	\$60,869,645
Security surplus: (140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million with a minimum of 110%, or 127%)	<u>69,970,269</u>
Security surplus excess (or deficit)	<u>\$(9,100,624)</u>

* Under Wisconsin's compulsory and security surplus calculation, investments in insurance subsidiaries may be counted toward satisfaction of requirements only to the extent that the value of an insurance subsidiary exceeds that insurance subsidiary's own security surplus requirement. BCBSUW's ownership of insurance subsidiaries is indirect through its ownership interest in Cobalt. The purpose of this adjustment is to limit the security surplus adjustment to an amount no greater than the value of BCBSUW's investment in Cobalt.

**Blue Cross & Blue Shield United of Wisconsin
Reconciliation and Analysis of Surplus
For the three-year Period Ending December 31, 2000**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1998	1999	2000
Surplus, beginning of year	\$228,075,088	\$198,515,391	\$142,424,134
Net income	1,842,679	(22,225,673)	(28,223,427)
Change in net unrealized capital gains or (losses)	(14,261,640)	(33,442,237)	(5,333,633)
Change in nonadmitted assets and related items	(17,140,736)	1,650,016	(4,510,945)
Write-ins for gains and (losses) in surplus:			
Transfer of Balances to UGS		(2,073,363)	
Surplus, end of year	<u>\$198,515,391</u>	<u>\$142,424,134</u>	<u>\$104,356,129</u>

Growth of Blue Cross & Blue Shield United of Wisconsin

Year	Admitted Assets	Liabilities	Surplus
1998	\$346,228,427	\$147,713,036	\$198,515,391
1999	274,787,547	132,363,413	142,424,134
2000	258,797,379	154,441,250	104,356,129

Year	Premiums Earned	Claims Incurred	Expenses Incurred	Combined Claim and Expense Ratio
1998	\$359,680,021	\$295,600,332	\$75,186,754	103.1%
1999	416,181,377	374,046,324	82,576,195	109.7
2000	534,399,173	490,524,165	81,215,201	107.0

During 1998, the company undertook a claims processing system conversion that did not go as smoothly as planned. It resulted in a significant backlog of unprocessed claims starting in 1998 and continuing through 1999. One of the consequences of the system conversion was that management did not have access to the trend information necessary to make adequate pricing decisions, which contributed to the company reporting underwriting losses over the past three years. The company's core comprehensive hospital medical policies and self-insured administrative arrangements contributed to those losses.

During 1999, the company surplus declined \$56 million as a result of a \$22.2 million net loss and a \$29 million decline in affiliated stock values. Effective January 1, 1999, the company reorganized its government services division into United Government Services, LLC and contributed \$4.5 million in cash and assets to the new affiliate. The decline in surplus during 2000 was primarily a result of another year of net losses and a decline in the value of affiliated stock.

Overall surplus declined by \$94 million or 47%, admitted assets declined 25%, and earned premium increased 48.5% during the period under examination. The decline in admitted assets is a result of declines in affiliated stock values and reductions in the bond portfolio. Premium increases were partly a result of increased rates. For 2000 some of the premium increase was due to the assumption of business from WCI.

Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus between that reported by the company and as determined by this examination:

Surplus December 31, 2000, per annual statement			\$104,356,129
	Increase	Decrease	
Affiliated Balances	\$ 0	\$ 3,948,484	
Claims Collection Receivable	0	<u>2,692,931</u>	
Net increase or (decrease)			<u>(6,641,415)</u>
Surplus December 31, 2000, per examination			<u>\$97,704,714</u>

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were five specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Investment—It is recommended that the company designate loaned securities with an “LS” per the annual statement instructions.

Action—Compliance

2. Investments—It is recommended that the company take steps to ensure that proper records are maintained concerning its securities lending transactions, pursuant to the requirements of s. Ins. 6.80, Wis. Adm. Code.

Action—Compliance

3. Escheatable Funds—It is recommended that the company

- a. Comply with s. 177, Wis. Stat., as regards unclaimed funds, and
- b. Submit to this office within 90 days of the adoption of this report, documentation verifying that these two checks were escheated to the State of Wisconsin Office of the State Treasurer as unclaimed property.

Action—Compliance

4. Schedule Y – Part 2—It is recommended that the company completed a common Schedule Y – Part 2 for inclusion in each of the affiliated insurers annual statements as required by the NAIC Annual Statement Instructions.

Action—Compliance

5. Schedule Y – Part 2—It is also recommended that the company report in Schedule Y – Part 2 all transactions required to be reported by the NAIC Annual Statement Instructions.

Action—Compliance

Summary of Current Examination Results

Executive Compensation

The examination review of the Report on Executive Compensation (Form OCI-040) for 2000 noted that the form is not being completed correctly. For example, the company is required to list any officer or employee whose total annual compensation is in excess of \$80,000. It was noted that one officer was not included in this report and should have been. It is recommended that the company complete the Report on Executive Compensation (Form OCI-040) in accordance with its instructions.

The review of the compensation amounts being reported indicated that amounts contributed by the company in connection with employee's 401K benefits were not included on Form OCI-040 for some employees. It is recommended that the company properly include all compensation amounts when completing the Report on Executive Compensation (Form OCI-040).

Corporate Records

The examination noted that the company had difficulties locating current signed corporate contracts, particularly affiliated agreements. The review entailed the comparison of what the company reported on Form B of the 2000 Holding Company Report to the agreements originally provided to the examiners upon a request for all affiliated agreements. In several instances the contracts were either not signed, did not contain the current cost allocation schedules, were not included on Form B, were terminated, or a combination of these problems. Eventually all the contracts were provided and all were properly signed. However, the company was not able to locate a few of the current cost allocation schedules. Similar problems were noted with the reinsurance contracts; such as locating signed copies and determining if the contract was active or not. It is recommended that the company maintain a glossary of corporate contracts, pursuant to s. 601.42, Wis. Stat. The glossary should include all affiliated agreements and reinsurance contracts without exception and be updated on a periodic basis so that the information will be current. A corporate contract glossary will aid the company with the completion of the annual holding company filings and ensure that all contracts are being properly reported.

Affiliated Investments

In July 2001, the NAIC Securities Valuation Office (SVO) issued its valuations for BCBSUW's affiliated investments for 2000 decreasing the values reported by the company by \$7,805,687.

Company	BCBSUW Reported Value	Value assigned by the SVO	Difference
AMSG	\$94,727,917	\$88,470,800	\$(6,257,117)
UWSI	8,426,694	7,821,249	(605,445)
UGS	6,989,936	6,048,811	(941,125)
Total			\$7,805,687

Review of these differences by the examination found that the company correctly valued its subsidiaries on its annual statement, but incorrectly completed the reporting forms to the SVO resulting in the valuation differences in UGS and AMSG. The company reported to the SVO that it owned 40% of AMSG, when it actually owned 44.8%. The company neglected to include a copy of the audited financial statements for UGS with its SVO filing and the SVO valued the subsidiary at statutory value instead of GAAP value as a result. It is recommended that the company correctly complete its annual SVO filings for its affiliated investments in the future. The company valuation for UWSI reflects the unamortized goodwill associated with BCBSUW's repurchases of UWSI stock for years prior to the BCBSUW and UWSI combination on March 26, 2001. Upon the BCBSUW and UWSI combination, the valuation for UWSI was reduced to \$0 based on the statutory book value of UWSI and the SVO's reciprocal ownership test. OCI has approved the continued presentation and amortization of prior goodwill associated with BCBSUW's market repurchases of UWSI stock prior to the combination. No adjustments to surplus were made by the examination for affiliated investments.

Affiliated Balances

The company reported an affiliated receivable with Cobalt, which had been accumulating since June 2000 and currently remains unsettled. As of December 31, 2000, the balance was \$8,891,280 with \$3,948,484 over 90 days past due. As of May 2001, the unsettled balance was approximately \$18.2 million. In light of the increasing amount and aging of balances due from affiliates, the examination has chosen to conservatively classify affiliated balances over 90 days past due as non-admitted assets for purposes of this examination. The examination has also determined that this conservative treatment is appropriate for future periods. Therefore, it is recommended that the company non-admit any unsettled affiliated balances that are over 90 days past due.

Effective April 1, 2001, the company started assessing imputed interest on unsettled intercompany balances without drawing up a formal agreement. The interest rate charged by BCBSUW was based on the One Month London Inter-Bank Offered Rates (LIBOR). As of June 30, 2001, no interest payments had been made. It is recommended that the company formalize this arrangement with a written agreement.

The review of the general ledger and bank account transactions indicated that during March 2001 Cobalt transferred \$15 million to BCBSUW and then reversed the transaction the next day. According to the Accounting Practices and Procedures Manual, SSAP No. 25, if a subsequent event or transaction reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal should be considered in determining whether economic substance existed in the case of the original transaction. It was also noted that BCBSUW and Compcare perform a similar transaction each quarter end to put Compcare in a payable position with BCBSUW. At December 31, 2000, this transaction consisted of a transfer of \$4 million from BCBSUW to Compcare on the last business day of the year. On the first business day of 2001, this transaction was reversed. It is recommended that the company not engage in any affiliated transactions that lack economic substance, as defined by SSAP No. 25.

Claims Collection Receivable

This balance consists of claim payments made in error and in the process of collection. The majority of this balance is claims that were paid on the company's South Carolina claims processing system. The company is properly non-admitting balances over 90 days past due for a portion of these receivables. However, included in that balance was a large amount of claims that were paid on behalf of BCBSUW's uninsured plans, a portion of which were from 90 to 760 days past due. According to NAIC Accounting Practices and Procedures /Life and Accident and Health (SSAP No. 47), "amounts receivable from uninsured plans for claims and other costs paid by the administrator on behalf of the third party at risk" meet the definition of assets. However, the prescribed procedures also dictate that "uncollected uninsured plan receivables (excluding Medicare and similar government) over ninety days due shall be accounted for as a nonadmitted asset. SSAP 47 took effect on January 1, 2001. The statutory guidance prior in effect on December 31, 2000, contained similar guidance on admission of amounts recoverable

related to uninsured accident and health plans. The Practices and Procedures Manual/Life and Accident and Health in effect on December 31, 2000, indicated that receivables related to uninsured accident and health plans "due and unpaid in excess of three months, except for those relating to Medicare or similar government plans, must be deducted and nonadmitted." It is recommended that uninsured accident and health plan receivables over 90 days past due be non-admitted. This recommendation resulted in a decrease to surplus of \$2,692,931.

Reinsurance Contracts

The review of the reinsurance contract between BCBSUW and Munich American Reassurance Company indicated that the insolvency clause did not contain language-guaranteeing payment of the liability of the reinsurer without diminution because of insolvency of the ceding company. Therefore, it is recommended that the contract with Munich American Reassurance Company be amended to include an insolvency clause which guarantees payment of the liability of the reinsurer without diminution because of insolvency of the ceding company, in compliance with Ins 52.03 (3), Wis. Adm. Code.

Accounts and Records

During the review of the company's policy files it was noted that the only way the company could gather information on the application was if an Internal Control Number (ICN) could be located on the company's system. In the sample the examiner selected, there were instances where the ICN could not be found, therefore no application could be provided to the examiner. It appears that without the ICN it is

almost impossible to locate the policy detail needed to complete the required audit procedures. It is recommended that the company maintain policy files in accordance with s. Ins 6.80 (4), Wis. Adm. Code in order to provide a clean audit trail.

Preferred Stock

During 1994, as part of a joint venture with Unity, BCBSUW acquired 1,500 shares of preferred stock of Health Professionals of Wisconsin, Inc. (HPI) at a cost of \$1,500,000. On the December 31, 2000 annual statement, this stock was reported at cost with a NAIC designation of P4U. According to the NAIC annual statement instructions a rating of P4 should be valued at the lower of cost or market. As this stock is a private placement, the company could not verify the market value, which could be zero. The examination received a copy of the December 31, 2000, financial statements for HPI and determined that no adjustment was necessary based on their net worth.

However, as a preferred stock that is not publicly priced BCBSUW is required to file, on an annual basis, documentation with the NAIC's Securities Valuation Office (SVO) for the purpose of obtaining a reasonable unit price. The company could not provide evidence of filing with the SVO. It is recommended that the company comply with the NAIC's Securities Valuation Office requirements concerning the Unit Price of preferred stock not publicly priced for its HPI investment.

Other Post Retirement Benefits

The company established an accrued liability for Other Post Retirement Benefits (OPRB) of \$933,212. The company only accrued a liability for participants who retired prior to November 1, 1986. The company asserts that plan amendments were made on that date to allow BCBSUW the ability to change or terminate benefits at its discretion, for individuals who retire after subsequent to that date, eliminating "vesting" of OPRB for those individuals, and justifying this accounting treatment. The company also amended its OPRB liability plan to discontinue company contributions for OPRB for employees hired on or after January 1, 1997. The examination noted, however, that while the 1997 plan amendment is disclosed in the notes to the statutory annual statement, no mention is made of the November 1, 1986 amendment. The annual statement instructions require the notes to contain a description of the plan, the method of determination and the amount of the postretirement expense and the amount of the amount of the postretirement obligation for nonvested employees. It is recommended

that the company fully describe the OPRB plan, the method of determination and the amount of the postretirement expense and the amount of the amount of the postretirement obligation for nonvested employees in the notes to future statutory annual statements.

VIII. CONCLUSION

During 1998, the company undertook a claims processing system conversion that did not go as smoothly as planned. It resulted in a significant backlog of unprocessed claims starting in 1998 and continuing through 1999. One of the consequences of the system conversion problems was that management did not have access to the trend information necessary to make adequate pricing decisions, which contributed to the company reporting underwriting losses over the past three years and net losses in two. As a result of the operating losses and unrealized losses on affiliated stocks, surplus declined \$94 million or 47% during the period under examination.

BCBSUW's Board of Directors announced in June 1999 its intention to convert from a nonprofit service insurance corporation to a stockholder owned corporation. An Application for a Plan of Conversion was filed with the commissioner on June 14, 1999. On March 28, 2000, Commissioner O'Connell approved a plan of conversion subject to a detailed list of conditions. On March 19, 2001, the Commissioner recognized BCBSUW's application as complete and the conversion under the order of March 28, 2000, was approved. Effective March 23, 2001, BCBSUW was converted to a stock corporation under ch. 611, Wis. Stat. and became a wholly owned subsidiary of UWSI. On that same day UWSI changed its name to Cobalt Corporation. The Wisconsin United for Health Foundation was created as part of the conversion process and became the majority owner of Cobalt's common stock. The foundation was established for the purpose of benefiting public health initiatives.

The current examination resulted in twelve recommendations, none of which were repeated from the prior examination. The examination resulted in two adjustments to surplus. In total surplus was decreased by \$6,641,415 and compulsory surplus excess was determined to be \$5,774,945 at December 31, 2000.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 28 - **Executive Compensation**—It is recommended that the company complete the Report on Executive Compensation (Form OCI-040) in accordance with its instruction.
2. Page 28 - **Executive Compensation**—It is recommended that the company include all compensation amounts when completing the Report on Executive Compensation (Form OCI-040).
3. Page 28 **Corporate Records**—It is recommended that the company maintain a glossary of corporate contracts, pursuant to s. Ins 601.42, Wis. Stat.
4. Page 29 **Affiliated Investments**—It is recommended that the company report its affiliated investments correctly to the NAIC Security Valuation Office in the future.
5. Page 30 **Affiliated Balances**—It is recommended that the company non-admit any unsettled affiliated balances that are over 90 days past due.
6. Page 30 **Affiliated Balances**—It is recommended that the company formalize this arrangement with a written agreement.
7. Page 30 **Affiliated Balances**—It is recommended that the company not engage in any affiliated transactions that lack economic substance, as defined by SSAP No. 25.
8. Page 31 **Claims Collection Receivable**—It is recommended that uninsured accident and health plan receivables over 90 days past due be non-admitted.
9. Page 31 **Reinsurance Contracts**—It is recommended that the contract with Munich American Reassurance Company be amended to include an insolvency clause which guarantees payment of the liability of the reinsurer without diminution because of insolvency of the ceding company, in compliance with s. Ins 52.03 (3), Wis. Adm. Code.
10. Page 32 **Accounts and Records**—It is recommended that the company maintain policy files in accordance with s. Ins 6.80 (4), Wis. Adm. Code in order to provide a clean audit trail.
11. Page 32 **Preferred Stock**—It is recommended that the company comply with the NAIC's Securities Valuation Office requirements concerning the Unit Price of preferred stock not publicly priced.
12. Page 33 **Other Post Retirement Benefits**—It is recommended that the company fully describe the OPRB plan, the method of determination and the amount of the postretirement expense and the amount of the amount of the postretirement obligation for nonvested employees in the notes to future statutory annual statements.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Lori Cretney	Insurance Financial Examiner
Tom Janke	Insurance Financial Examiner
Sarah Haeft	Insurance Financial Examiner
Danielle C. Rogacki	Insurance Financial Examiner

Respectfully submitted,

Eleanor Opprieht
Examiner-in-Charge